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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Amendment of the Commission's Rules to Establish Competitive Service Safeguards for Local Exchange Carrier Provision of Commercial Mobile Radio Services	)	WT Docket No. 96-162
	)	
Implementation of Section 601(d) of the Telecommunications Act of 1996, and Sections 222 and 251(c) of the Communications Act of 1934	)	DOCKET FILE COPY ORIGINAL
	)	
Amendment of the Commission's Rules to Establish New Personal Communications Services	)	GEN Docket No. 90-314
	)	
Requests of Bell Atlantic-NYNEX Mobile, Inc., and U S WEST, Inc. for Waiver of Section 22.903 of the Commission's Rules	)	

COMMENTS OF U S WEST, INC.

Jeffrey S. Bork
Sondra J. Tomlinson
U S WEST, Inc.
1020 19th Street, N.W., Suite 700
Washington, D.C. 20036
303-672-2700

Daniel L. Poole, Of Counsel

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Summary of U S WEST's Comments

U S WEST opposes the proposals to require BOCs to place their in-region PCS operations into a separate affiliate, and to impose structural and other requirements on them. The Commission has already determined that no such safeguards are necessary for BOC provision of PCS. If anything, the intervening legislative, regulatory, and market developments point toward fewer, not more, regulatory requirements and restrictions.

In particular, there is no need for any additional "interconnection safeguards." Sections 251 and 252 of the 1996 Act, coupled with the rules implementing them and backed up by vigorous state and federal enforcement, provide a high degree of protection against discriminatory interconnection practices. The new pricing and unbundling rules also ensure that BOCs cannot leverage any market power they may possess in the local exchange market into the CMRS market.

Nor are BOCs capable of dominating the CMRS market. The CMRS spectrum caps preclude anyone — including a BOC — from obtaining market power in the wireless market by limiting the amount of spectrum any firm can directly or indirectly hold in any geographic area. Moreover, the flourishing CMRS industry is populated with several large, experienced telecommunications companies and many smaller players which are rapidly entering the market. In this environment, BOCs offering PCS cannot control prices or exclude entry. Nor could they successfully engage in predation (*e.g.*, below cost

pricing with the intent to drive out competitors) because recoupment of losses would be impossible.

Furthermore, any concerns that the Commission may have about potential BOC abuse of market power in the local exchange market should quickly abate as the changes triggered by the 1996 Act take hold. BOC market power in the local exchange market has diminished and will continue to diminish rapidly. In the meantime, the D and E Block PCS spectrum auctions are still going on. As a practical matter, it probably will be six to twelve months before any BOC bidding in those auctions could even begin to offer PCS service. By that time, the local exchange and CMRS markets will look very different than they do today. The Commission should not adopt a long-term solution (*e.g.*, separate affiliate) for what may be, at worst, a short-term issue.

U S WEST also observes that there are at present differences between PCS and cellular and that the Commission may decide that these temporary differences may warrant in regulatory treatment between cellular and PCS. As new entrants, PCS companies face many hurdles that the incumbents do not face, and in order to ensure that competition continues to develop rapidly in the CMRS market, the Commission would be justified in retaining the recently-liberalized cellular structural separation requirement for a very limited period of time.

Finally, in regard to the rules for CPNI, U S WEST urges the Commission to adopt a more natural reading of Section 222 than it proposed in the main CPNI docket (CC No. 96-115). The proposed "three-distinct-services" approach is unworkable and would confound customer expectations and desires for "one-stop-shopping." The language of the statute and the legislative history support a broader interpretation that will enable all telecommunications carriers — including BOCs —to develop and offer specialized services and packages that are tailored to their customers' needs.

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U S WEST COMMENTS

U S WEST, Inc. submits these comments in response to the Notice of Proposed Rulemaking, FCC 96-319 (Aug. 13, 1996), 61 Fed. Reg. 46420 (Sept. 3, 1996) ("Notice").[1]

I. INTRODUCTION

In a marked departure from recent decisions permitting incumbent LECs to provide PCS services on an integrated basis with minimal regulatory burdens, the Commission now proposes to subject these LECs to an array of new regulatory conditions, including a separate affiliate requirement, when they provide PCS. It was only three years ago that the Commission ruled that interconnection and accounting rules then in effect ren-

[1] U S WEST's Media Group (NYSE: UMG) owns the cellular carrier, U S WEST NewVector, although it is in the process of merging this property into the cellular properties owned by AirTouch Communications. After the merger, the Media Group will hold a minority interest in the combined cellular operations.

U S WEST's Communications Group (NYSE: USW) is currently participating in the D and E block PCS auction.

dered unnecessary any need to impose additional "safeguards" on LEC provision of PCS.[2] In fact, the Commission expressly determined that separate affiliate/subsidiary requirements in particular would "seriously limit[] the ability of LECs to take advantage of their potential economies of scope, . . . [and] would jeopardize, if not eliminate, the public interest benefits we seek through LEC participation in PCS."[3] The Commission reinforced the validity of this ruling last fall when it proclaimed that the "proposed integration of wireless and landline services offers substantial benefits to consumers by avoiding duplicative costs, increasing efficiency, and enhancing [the provider's] ability to provide innovative service."[4]

U S WEST does not understand why the Commission is now proposing to go backwards on PCS.[5] Only two developments of substance have occurred since the Commission rendered the decision it now proposes to overturn. First, the landline and CMRS markets have each become increasingly competitive. Second, Congress has enacted the "pro-competitive, deregulatory" Telecommunications Act of 1996.[6] These de-

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[2] *See* Broadband PCS Order, 8 FCC Rcd 7700, 7747-52 ¶¶ 112-27 (1993), *on recon.,* 9 FCC Rcd 5154 (1994).

[3] Id. at 7752 ¶ 126.

[4] SBMS Rule 22.903 Waiver Order, 11 FCC Rcd 3386, 3395 ¶ 19 (1995).

[5] The Commission is also proposing to go backwards on SMR. *See* Notice at 58 ¶ 126 (tentatively concluding that nonstructural safeguards proposed for LEC/PCS should apply to their provision of "other in-region CMRS"). Just last year the Commission held that no new "safeguards" (including separate subsidiary/affiliate requirements) were necessary for LECs to provide SMR and dispatch services. *See* Landline SMR Eligibility/Safeguards Order, 10 FCC Rcd 6280 (1995). After carefully reviewing the arguments of those advocating additional regulatory burdens, the Commission concluded that "existing regulatory safeguards are sufficient to prevent possible discrimination and cross-subsidization." Id. at 6293 ¶ 22. The analysis in the text above with respect to PCS applies with equal force to SMR.

[6] *See* S. Conf. Rep. No. 230, 104th Cong., 2d Sess. 1 (1996)(Joint Explanatory Statement).

velopments render even more unnecessary the regulatory burdens the Commission refused to impose in 1993 and again last year.

This backpedaling on PCS is especially perplexing in view of the current competitive CMRS landscape, built-in safeguards that already exist (*e.g.,* interconnection rules, spectrum caps), and the many changes which are revolutionizing the telecommunications industry. There was no reason to impose additional "safeguards" for PCS before, and there certainly is no reason to impose them now.

The source of the Commission's change of heart is not apparent, especially given the absence of any complaint that LECs are violating current safeguards or are dominating the CMRS market. The proposed policy reversal seems to be based on the concern that — as a result of integration — the BOCs might advantages in the CMRS market that others do not enjoy. But, as the Commission itself has noted:

> The issue is not whether [the incumbent] has advantages, but, if so, why, and whether any such advantages are so great as to preclude the effective functioning of a competitive market. . . . Such advantages do not . . . mean that these markets are not competitive . . . [or] that it is appropriate for government regulators to deny the incumbent the efficiencies its size confers in order to make it easier for others to compete.[7]

The key question of whether a BOC offering of PCS service on an integrated basis is likely to preclude the effective functioning of the CMRS market is never squarely raised in the Notice.

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[7] Competition in the Interstate Interexchange Marketplace, 6 FCC Rcd 5880, 5891-92 ¶ 60 (1991). *See also* AT&T/McCaw Transfer Order, 9 FCC Rcd 5836, 5862 ¶ 38 (1994).

The Commission appears to believe that the numerous separate affiliate requirements in the 1996 Act somehow justify imposing similar requirements on incumbent LEC provision of PCS.[8] The Commission is correct in noting that Congress has concluded that "separate affiliate requirements . . . constitute an appropriate initial safeguard for BOC entry into the provision of certain competitive services, which can be phased out as markets become more competitive."[9] However, BOC provision of PCS, including interLATA CMRS, is not among the services for which Congress saw the need for a separate affiliate.[10]

The Commission also characterizes its separate affiliate proposal as "unexceptional" because three BOCs apparently have announced plans to use a separate PCS affiliate at least in part.[11] These three BOCs may indeed have determined that the partial use of a separate affiliate is a "reasonable business practice."[12] However, for the Commission to conclude from this that another BOC's decision to instead integrate completely its PCS operation constitutes an unreasonable business practice would be errone-

[8] *See* Notice at 54 ¶ 117 (Separate affiliate requirements are "consistent with the approach taken by Congress in the 1996 Act with respect to BOC entry into previously prohibited or restricted services. For these reasons, we propose to require that LEC in-region broadband PCS services should be provided through a corporate affiliate that is separate from the local exchange carrier."). It perhaps bears noting that LECs have never been prohibited from providing cellular or PCS services.

[9] Notice at 19-20 ¶ 40 (emphasis added).

[10] Moreover, while Congress did not remove the Commission's cellular separate subsidiary requirement (Rule 22.903), it did liberalize the rule by permitting BOCs to jointly market and resell cellular service — activity which the Commission had prohibited. *See* Section 601(d) of the Telecommunications Act of 1996. *See also* Notice at 28-32 ¶¶ 61-68.

[11] *See* Notice at 54 ¶ 117.

[12] Ibid.

ous. Each BOC serves different markets and faces a different competitive landscape. The Commission's proposed "one-size-fits-all" approach to BOC/PCS is unduly restrictive, and what other BOCs have chosen to do is a wholly inadequate justification for requiring others to conform to that approach. All carriers, including BOCs, should have the flexibility to employ whatever business structure makes sense for them, based on their unique circumstances.

Consistent with arguments made recently by certain incumbent non-BOC cellular carriers, which would prefer to hobble their new entrant competitors with new regulatory burdens they, themselves, do not face,[13] the Commission now attempts to place the burden on the BOCs to prove the benefits of integration and the costs of separation. Indeed, the Commission seems to expect the BOCs to make detailed factual showings to justify the *status quo* — that is, continued integration.[14]

U S WEST submits that here, too, the Commission has it backwards. Given the Commission's 1993 decision finding that new regulatory burdens are unnecessary and "would jeopardize, if not eliminate, the public interest benefits we seek through LEC participation in PCS," given its re-affirmation of this decision last year,[15] and especially given the enactment of the 1996 Act, the burden must be placed on the proponents of additional "safeguards" to demonstrate their need. As the Commission itself has ac-

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[13] *See* Notice at 15 ¶ 30.

[14] *See* id. at 24 ¶ 52.

[15] *See* Landline SMR Eligibility/Safeguards Order, note 5 *supra*.

knowledged, competitive safeguards legally can be imposed "only where a demonstrated need exists."[16] Here, there is no need for any of the proposed LEC/PCS safeguards.

II. THERE IS NO BASIS FOR SUBJECTING BOC PROVISION OF PCS TO SPECIAL CONDITIONS, INCLUDING STRUCTURAL SAFEGUARDS.

The Commission proposes imposing new government regulations on BOCs providing PCS. Among other things, it contemplates ordering BOCs to place their CMRS operations in "separate affiliates" that cannot own switching or transmission facilities jointly with their landline exchange companies.[17] The proposed "separate affiliate" requirement — though certainly less stringent than the Computer II requirements — is nevertheless a form of structural separation that would impose costs on the BOCs and consumers alike through unnecessary expenditures and lost efficiencies.

Any benefits of a "separate affiliate" requirement are at best slight, especially in view of current safeguards in the CMRS and local exchange services markets. The most explicit justification for the separate affiliate requirement is that it will "render visible the LEC's interconnection arrangements with its affiliate."[18] But the 1996 Act and the rules implementing Sections 251 and 252 already protect against discriminatory interconnection. Moreover, as demonstrated below, the Commission has determined in other contexts that structural safeguards were not necessary to make the BOCs' integrated delivery

[16] Notice at 5 ¶ 11.

[17] Id. at 54 ¶ 118.

[18] Id. at 56 ¶ 123.

of services transparent to regulators. No new "interconnection safeguards" are needed here either.

The Commission also suggests that the separate affiliate requirement is needed to prevent LECs from "leveraging [their] local exchange market power into the more competitive . . . CMRS market."[19] But the structure and nature of the CMRS industry (*e.g.*, spectrum caps, TELRIC pricing, number and size of competitors) make it impossible for any incumbent LEC to control prices in the CMRS market. Furthermore, LECs cannot control prices in the local exchange market because those prices are fully regulated. Nor can they exclude entry, because the interconnection and competition rules contained in the 1996 Act have removed barriers to entry into the local exchange market.[20] Since the Commission appears to have underestimated the pervasive effects of existing safeguards on the provision of CMRS and local exchange service, U S WEST discusses those effects below.

A. Because BOCs Cannot Obtain Unfair Advantages in the CMRS Market, They Should Not Be Subject to Special Rules Such As a "Separate Affiliate" Requirement

Sections 251 and 252 of the 1996 Act, coupled with the Commission's recent order implementing them, provide numerous "interconnection safeguards" that are more

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[19] Notice at 22-23 ¶ 47. By "market power," the Commission presumably means "the ability to raise and maintain price above the competitive level without driving away so many customers as to make the increase unprofitable." *See, e.g.*, Payphone Reclassification/Compensation Order, Docket 96-128, FCC 96-388, at 115 ¶ 228 (Sept. 20, 1996), *quoting*, Fourth Competitive Carrier Report, 95 F.C.C.2d 554, 558 ¶ 7 (1978).

[20] "It is well known that some of the most insuperable barriers in the great race of competition are the result of government regulation." United States v. Syufy Enterprises, 903 F.2d 659, 673 (9th Cir. 1990).

than sufficient to prevent BOCs from engaging in anticompetitive practices in the CMRS market. As the Commission has already acknowledged, Section 251 "imposes extensive interconnection obligations on . . . LECs and incumbent LECs."[21] What is more, Congress has now "constrain[ed] the incumbent LEC's ability to perpetuate its market power through the pricing of interconnection and unbundled elements, . . . [by specifying] that the prices for such transactions should be cost-based and just and reasonable."[22] These interconnection and pricing standards, combined with the enforcement power of both this Commission[23] and state regulators,[24] prevent any BOC from using its ownership over landline facilities to prevent entry or raise the costs of competitors in the CMRS market.

Under Section 251, on request from any CMRS provider, an incumbent LEC must interconnect with that carrier "on rates, terms, and conditions that are just, reasonable, and nondiscriminatory;"[25] and the incumbent must provide the requester with "nondiscriminatory access to network elements on an unbundled basis . . . on rates, terms, and conditions that are just, reasonable, and nondiscriminatory."[26] The Act defines those "just and reasonable" rates in terms of economic costs.[27]

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[21] Notice at 17 ¶ 35.

[22] Local Competition NPRM, Docket 96-98, FCC 96-182, at 6 ¶ 8 (April 19, 1996).

[23] Id. at 42-44 ¶¶ 126-28 (discussing Commission authority to enforce pricing, unbundling, and nondiscrimination standards through section 208 complaint process).

[24] 47 U.S.C. § 252(e)(2).

[25] 47 U.S.C. § 251(c)(2)(D).

[26] 47 U.S.C. § 251(c)(3).

[27] 47 U.S.C. § 252(d)(1) and (2).

The Commission has already used these provisions of the Act to restructure the interconnection relationships between incumbent LECs and wireless providers.[28] As Commissioner Chong acknowledged recently, the Commission's "interconnection order goes a long way towards ensuring that wireless providers will pay fair, reasonable and nondiscriminatory interconnection rates."[29] For example, under that order:

- LECs cannot charge different interconnection rates for landline and wireless providers.
- LECs can no longer charge providers for the traffic the LEC originates.
- LECs must pay mutual compensation for interconnection, and the rates must generally be symmetrical.
- CMRS providers with non-mutual compensation arrangements can re-negotiate those agreements without incurring any early termination penalties.
- New entrants without interconnection agreements can pay default proxy rates while negotiating agreements.
- Pick-and choose clauses in all interconnection agreements, ensuring that all interconnecting carriers, including wireless carriers, can be certain that they are always getting the lowest available rate.[30]

Further, the Commission has interpreted "just and reasonable" rates as "TELRIC" — total forward-looking long-run incremental costs, including a share of joint and common costs but devoid of any cross-subsidies of other services.[31] Given the TELRIC pric-

[28] *See* Local Competition First Report, Docket 96-98, FCC 96-325, at 476-596 ¶¶ 999-1248 (Aug. 8, 1996).

[29] Remarks of Commissioner Rachelle Chong to the Personal Communications Industry Association '96 Conference, It's a New World and Welcome to It, at 3 (Sept. 19, 1996).

[30] Ibid.

[31] Local Competition First Report at 17 ¶ 29.

ing standard, it is no longer possible for an incumbent LEC to obtain any unfair advantage in the CMRS market, because no service may cross-subsidize any other. Moreover, the Commission's unbundling rules eliminate barriers to entry into the local exchange market by eliminating the natural monopoly and requiring all economies of scale to be shared.[32] As a result, the Commission has recognized that the Act's pricing and unbundling standards effectively "prevent incumbent LECs from exploiting their market power at the expense of their competitors that are dependent on the incumbent LEC's facilities."[33]

Other safeguards would prevent a BOC offering integrated PCS service from profitably raising prices above competitive levels in the CMRS market and maintaining those increases.[34] The Commission's CMRS spectrum allocation policies are designed to "ensure that no CMRS provider will exert market power by controlling large amounts of spectrum in a given geographic market."[35] Under the broadband spectrum cap, no one firm can directly or indirectly acquire more than 45 MHz of broadband CMRS spectrum in a given geographic area. Even if a firm acquired this maximum amount, it would still

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[32] Id. at 10 ¶ 11.

[33] Id. at 307 ¶ 635. The Commission in effect endorsed the position of the Department of Justice, which had argued that "the adoption of a TSLRIC standard will prevent ILECs from continuing to exploit their market power — by charging more than competitive prices for network elements — at the expense of their competitors who are dependent on ILEC facilities." Comments of U.S. Department of Justice, Docket 96-98, at 29 (May 16, 1996). *See* Local Competition First Report at 307 ¶ 635.

[34] In-Region InterLATA NPRM, Docket 96-149, FCC 96-308, at 67 ¶ 137 (July 18, 1996)(Commission dismisses the possibility that a BOC could raise prices in the interLATA market).

[35] Second CMRS FNPRM, 9 FCC Rcd 4400 ¶ 1 (1994). *See also* CMRS Spectrum Cap Order, 11 FCC Rcd 7824, 7869 ¶ 95 (1996) ("The continuation of the 45 MHz spectrum cap will promote competition and prevent anti-competitive horizontal concentration in the CMRS business.").

control less than 25% of the available licensed spectrum in that area.[36] As the Commission itself has noted, this regime effectively prevents any provider — including one affiliated with an incumbent LEC — from acquiring undue power in the CMRS market.[37]

Nor could a BOC offering PCS service on an integrated basis engage successfully in predation in the CMRS market. Most of the CMRS players are well-established companies with substantial resources, large customer bases, brand recognition, and other advantages. A BOC plainly could not drive an AT&T/McCaw from the market. Even if it could, the BOC would not be able to profit from its predation by raising prices to recoup lost revenues: the spectrum capacity of the victim of predatory pricing would remain intact, available for another firm to buy at a distress sale and to use to undercut any attempt by the predator to raise prices above competitive levels.[38] As the Supreme Court has recognized, competitors have no incentive to engage in predatory pricing when they are unable to profit from doing so.[39] The CMRS market is, therefore, sufficiently competitive

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[36] A total of 198 MHz of spectrum has been allocated for licensed broadband CMRS services: 50 MHz for cellular, 120 MHz for PCS, and 28 MHz for SMR (806-824 MHz, 851-869 MHz, 896-901 MHz, 935-940 MHz, including 150 contiguous 25 kHz General Category channels). In addition, the Commission has allocated 30 MHz of unlicensed PCS spectrum (1910-1930 MHz; 2390-2400 MHz) which the public is free to use for any purpose.

[37] *See, e.g.*, Landline SMR Eligibility/Safeguards Order, 10 FCC Rcd 6280, 6291-92 ¶ 20 (1995) ("[W]e note that wireline SMR acquisitions will be subject to our CMRS spectrum cap, which restricts the amount of cellular, broadband PCS and SMR spectrum that any one entity may acquire in a geographic market. This acts as a competitive safeguard by limiting all wireline carriers from exerting undue market power in these services.")

[38] *See* In-Region InterLATA NPRM, Docket 96-149, FCC 96-308, at 67 ¶ 137 (July 18, 1996) (same analysis with respect to in-region interLATA market).

[39] *See* Brooke Group v. Brown & Williamson Tobacco, 113 S. Ct. 2578, 2589 (1993)("Recoupment is the ultimate object of an unlawful predatory pricing scheme; it is the means by which a predator profits from predation. Without it, predatory pricing produces lower aggregate prices in the market, and consumer welfare is enhanced."). *See also* Matsushita Electric Industries v. Zenith Radio, 475 U.S. 574, 589 (1986) (noting that predatory pricing schemes are "rarely tried, and even more rarely successful").

that no competitor, BOC or otherwise, could acquire undue market power or exercise it for any period of time.

Given the protections and safeguards that already exist, the benefit of structural separation for BOC in-region CMRS operations is marginal at best, and is vastly outweighed by the additional costs those restrictions would impose on the BOCs and, ultimately, on consumers. The Commission has properly recognized that restrictions on the integrated delivery of BOC services increase customer costs by denying providers the most efficient forms of corporate and operational organization, noting that structural separation "entails costs to the carriers, in the form of lost efficiencies of scope . . . as well as lost opportunities to consumers to obtain integrated and innovative service packages."[40] No clear benefit or "demonstrated need" for additional government regulations and burdens balances — much less outweighs — these costs.

Imposing a "separate affiliate" requirement on BOCs' provision of PCS would be a clear step backwards. Over the past ten years, the Commission has properly turned away from structural separation regimes, recognizing that behavioral and accounting safeguards are as effective in preventing the leveraging of market power in local exchange services into new markets, even where those new markets are closely related to exchange service or provision of the new services would rely heavily on local exchange facilities. For example, the Commission has ruled that nondiscrimination, accounting,

[40] Notice at 18-19 ¶ 38.

and network disclosure safeguards suffice to prevent BOCs from cross-subsidizing or discriminating in favor of their operations in two markets closely tied to landline service — enhanced services[41] and customer-premises equipment[42] — without the inefficiencies that attend structural regulation.

Indeed, less than two weeks ago, the Commission declared that its nonstructural Computer III safeguards are sufficiently comprehensive, and the Commission's ability to apply them so refined by experience, that it will allow BOCs to provide payphone service (which shares far more central-office and transmission facilities with the exchange telephone company than does CMRS) on a structurally integrated basis, under these safeguards alone.[43] The Commission allowed this integrated delivery even though Congress expressly specified that Computer III safeguards were the minimum permissible level of regulation.[44]

Here, by contrast, the Commission proposes a new "separate affiliate" requirement for PCS, although Congress has prescribed no special safeguards for these services in the 1996 Act — not even Computer III safeguards. The Commission has identified

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[41] Computer III Remand Order, 6 FCC Rcd 7571 (1991), *vacated in part sub nom.*, California v. FCC, 4 F.3d 1505 (9th Cir. 1993).

[42] BOC CPE Relief Order, 2 FCC Rcd 143 (1987).

[43] Pay Telephone Reclassification/Compensation Order, Docket 96-128, FCC 96-388, at 73, 100 ¶¶ 145, 199 (Sept. 20, 1996). Enhanced services, too, rely heavily on local exchange switching and transmission facilities: the same switches and wires often provide both enhanced and exchange services.

[44] *See* 47 U.S.C. § 276(b)(1)(C) (ordering the Commission to prescribe safeguards for BOC delivery of payphone service "which . . . shall, at a minimum, include the nonstructural safeguards equal to those adopted in the Computer Inquiry-III" proceeding).

nothing about the provision of CMRS that distinguishes it from the delivery of enhanced services, CPE, or payphone services and justifies singling out a BOC's integrated provision of CMRS for extra regulatory burdens.

B. In the Face of the 1996 Act and Increased Competition, Incumbent LECs Will Not Be Able to Exercise Market Power in the Local Exchange Service Market

To justify imposing more restrictive "safeguards" on the BOCs' provision of PCS services, the Commission must find that, in the absence of the safeguards, BOCs would be able to leverage power in another market to harm competitiveness in the PCS market. The Commission must also find that BOCs will, as an initial matter, have sufficient market power in another market to use as leverage into PCS markets.

Although the Commission recently stated reflexively that the BOCs possess market power in the local exchange market,[45] it apparently based its conclusion largely on the BOCs' current share of that market.[46] Such a static analysis is misleading and fails to capture the most relevant factors in the determining the existence of market power. The current market position of BOCs provides only limited insight into their ability to take

[45] Market power is the ability profitably to raise and maintain price above a competitive level and reduce output for a significant period of time. Payphone Reclassification/Compensation Order, Docket 96-128, FCC 96-388, at 115 ¶ 228 (Sept. 20, 1996), *quoting* Fourth Competitive Carrier Report, 95 F.C.C.2d 554, 558, ¶ 7 (1978); DoJ/FTC 1992 Horizontal Merger Guidelines, § 0.1, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,104. *See also* AT&T/McCaw Transfer Order, 9 FCC Rcd 5836, 5850 n.44 (1994), *quoting* Eastman Kodak v. Image Technical Services, 504 U.S. 451, 464 (1992) ("Market power is the power to force a purchaser to do something that he would not do in a competitive market. . . . It has [been] defined as the ability of a single seller to raise price and restrict output."); 47 C.F.R. § 61.3(d) (defining "dominant carrier" as a "carrier found by the Commission to have market power (*i.e.* power to control prices).").

[46] Accounting Safeguards NPRM, Docket 96-150, FCC 96-309, at 5 ¶ 6 (July 18, 1996)("BOCs currently possess market share for local exchange and exchange access in areas where they provide such services of approximately 99.5 percent as measured by revenues.").

actions normally associated with the exercise of market power. The Commission needs to take account of the dramatic changes that the 1996 Act has taken in facilitating "a pro-competitive, de-regulatory" local exchange market.[47]

Courts, economists, and the federal antitrust enforcement agencies have long recognized that determination of market shares is only a starting point for the inquiry into whether a firm possesses market power and has the ability to exercise it.[48] In their 1992 Horizontal Merger Guidelines, the federal antitrust enforcement agencies recognize that "market share and market concentration data may . . . overstate the likely future competitive significance of a firm or firms in the market."[49] The Guidelines require an inquiry into market conditions to determine whether the relevant market shares are, in fact, reflective of conditions in the market. In particular, the Guidelines recognize that market

[47] As the Seventh Circuit recognized in the telecommunications context, "[r]eliance on market share statistics is likely to be an inaccurate or misleading indicator of "monopoly power" in a regulated setting. . . . The firm's statistical dominance may . . . be the result of regulation." MCI Communications v. AT&T, 708 F.2d 1081, 1107 (7th Cir.), *cert. denied*, 464 U.S. 891 (1983). *See also* Southern Pacific v. AT&T, 740 F.2d 908, 1000 (D.C. Cir. 1984)("Reliance on statistical market share is a questionable approach in cases involving regulated industries."); Metro Mobile v. NewVector Communications, 892 F.2d 62, 63 (9th Cir. 1989)(Reliance on market share to show market power in cases involving regulated industries is "at best a tricky enterprise" and is "downright folly" where the predominant market share is the result of regulation.).

[48] Moreover, the market shares associated with the LECs may be misleading for at least two reasons. First, a LECs' share of the local exchange market includes numerous customers that it is required to serve by state universal service obligation requirements; in general, LECs earn no profit in serving those customers and, absent their universal service obligations, would not choose to serve them. Second, it is difficult to calculate accurately current shares of exchange access markets since some CAPs provide direct access services to incumbent LEC customers. For these reasons, to the extent market shares are viewed as relevant to the determination of the existence of market power, the calculation of those shares must be undertaken with care to avoid an overstatement of a LEC's true market position.

[49] DoJ/FTC 1992 Horizontal Merger Guidelines § 1.52. The Commission has adopted the Merger Guidelines analysis of market power on a number of occasions. *See, e.g.*, In-Region InterLATA NPRM, Docket 96-149, FCC 96-308, at 11 ¶ 15 n.36 (July 18, 1996); Second CMRS Resale NPRM, 10 FCC Rcd 10666, 10701 ¶ 69 (1995); CMRS Equal Access NPRM, 9 FCC Rcd 5408, 5425 n.86 (1994).

share data is necessarily historical and thus, in markets where competitive conditions have changed or are changing, it is necessary to consider carefully whether those changes will prevent an entity with high market shares from exercising market power.[50]

Market share data is especially questionable in an industry undergoing rapid technological and structural changes.[51] No industry is facing a more rapid change in technology and market structure than the local exchange business. Less than a year ago, the LECs were substantially protected from competition by a myriad of state laws and regulations. Actual and potential entrants faced at least three types of barriers to their entry or expansion in most telecommunications markets: (1) the existence of exclusive local fran-

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[50] 1992 Horizontal Merger Guidelines § 1.521 ("Market concentration and market share data of necessity are based on historical evidence. However, recent or ongoing changes in the market may indicate that the current market share of a particular firm either understates or overstates the firm's future competitive significance.").

The Supreme Court recognized the potentially misleading nature of market share statistics in Brown Shoe v. United States, where the Court cautioned that "only a further examination of the particular market — its structure, history and probable future — can provide the appropriate setting for judging [] probable anticompetitive effect." 370 U.S. 294, 322 n.38 (1962). *See also* United States *v.* General Dynamics, 415 U.S. 486, 503 (1974)(noting that while current and historic market shares of merged entities were high, those entities would be unable to harm competition "[i]rrespec-tive of the company's size" because they had very limited reserves of coal for future sales and most of their current reserves were already committed through long-term contracts and thus would be unlikely to be a source of market power.").

The Commission, too, has recognized that "[i]n light of the changes taking place in the telecommunications industry, it is important to emphasize that market share and market concentration data, evaluated alone, may either understate or overstate the likelihood of firms being able to exercise market power in the future." Payphone Reclassification/Compensation Order, Docket 96-128, FCC 96-338, at 116 n.763 (Sept. 20, 1996). *See also* Interstate Interexchange Marketplace, 6 FCC Rcd 5880, 5890 ¶ 51 (1991)("[M]arket share alone is not necessarily a reliable measure of competition . . . .").

[51] *See generally* R. Hartman, D. Teece, W. Mitchell & T. Jorde, Assessing Market Power in Regimes of Rapid Technological Change, Vol. 2, No. 3 Industrial and Corp. Change 319 (1993) ("In high technology industries, the competitive positions of firms are never secure; incumbents, even those that appear dominant, can be unseated with alacrity by new technologies developed by others. Market positions built on a technological base which is changing rapidly are vulnerable to being overturned by new entrants from outside the industry as well as by competitors within it.").

chises; (2) economic barriers of scope and scale; and (3) operational barriers, including lack of number portability, dialing parity, and access to rights of way.[52]

The 1996 Act has swept away those entry barriers, giving new and existing entities the opportunity to enter and expand into services and markets that had been largely reserved to the LECs.[53] Indeed, earlier this week the Commission noted that the Act "remove[s] not only statutory and regulatory impediments to competition, but economic and operational impediments as well."[54] In particular, sections 251-253 of the 1996 Act are deliberately designed to eliminate entry barriers by, *inter alia*:

- Eliminating state-granted exclusive LEC franchises;
- Requiring LECs to interconnect with new entrants at reasonable and nondiscriminatory prices;
- Permitting new entrants to the use elements of the LECs' networks on a unbundled basis; and
- Requiring LECs to provide number portability, dialing parity, and unencumbered access to rights of way.

These provisions create the opportunity for unrestricted entry into the LECs' local exchange and exchange access business by eliminating each of the entry barriers identified

[52] Local Competition First Report, Docket 96-98, FCC 96-325, at 10-13, ¶¶ 10-20 (Aug. 8, 1996).

[53] "No state or local statute or regulation . . . may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications services." 47 U.S.C. § 253(a). The Commission has declared that "[t]he 1996 Act seeks to eliminate artificial legal and regulatory barriers, as well as economic impediments, to entry into telecommunications markets." In-Region InterLATA NPRM, Docket 96-149, FCC 96-308, at 6 ¶ 5 (July 18, 1996).

[54] Classic Telephone Preemption Order, CCBPol 96-10, FCC 96-397, AT 14-15 ¶ 25 (Oct. 1, 1996), *quoting* Local Competition First Report at ¶ 3.

by the Commission. Indeed, the 1996 Act, along with the Commission's implementing orders, have already resulted in new entry, less than eight months after its passage.[55]

While the LECs' existing and potential competitors have been freed from their regulatory constraints, the LECs themselves remain captive to a system of rate and service regulation that prevents them from controlling price and substantially impairs their ability to respond to any new entry into their lines of business. State and local pricing and service regulation require LECs to subsidize below-cost residential service with extra-competitive pricing of other LEC-provided services. The CAPs have already used this mandated cross-subsidization to enter markets in which LECs have been forced to keep prices above competitive levels. This pattern will continue now that entry is permitted into the LECs' other lines of business. The experience with the CAPs demonstrates that, if LECs seek to price services above competitive levels in the absence of regulatory entry barriers, they will face significant competition from new entrants.

Moreover, the entire telecommunications industry is facing rapid technological change. Customers are demanding new services, and new ways of providing both these new services and more traditional services are being introduced that call into question the value and necessity of the LECs' existing infrastructure. Already cable and long-distance

[55] U S WEST has identified at least 61 separate interconnection agreements that have been entered into by the LECs since the passage of the 1996 Act. U S WEST itself is engaged in negotiation or arbitration for at least 42 separate interconnection agreements.

providers are preparing to provide local exchange services.[56] Some CAPs already provide these services. Other new developments will continue to undermine whatever advantage the LECs may gain from their current market position. These changes will continue at an accelerating rate, particularly as new entrants and new customers offer and demand new services and service options.

In sum, the LECs face market conditions making it unlikely that they have or will have the market power — much less the ability to exercise that power in CMRS markets — that their current market local exchange shares might be thought to imply. It is highly unlikely that any LEC could successfully undertake the sort of anticompetitive actions associated with the exercise of market power, even in its core businesses. Given this, the imposition of restraints on LEC provision of CMRS services out of fear that the LECs now or in the future will be able to exercise market power in those markets is wholly unnecessary. Indeed, as Commissioner Chong noted recently, because the 1996 Act and the Commission's implementing orders have eased entry barriers, "[l]ocal telephone monopolies are basically passé."[57]

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[56] For example, U S WEST's Media Group is investing $250 million in its Atlanta-area cable TV subsidiary, MediaOne, to upgrade its system to provide competitive local exchange services by the end of the year.

[57] Remarks of Commissioner Rachelle Chong to the Personal Communications Industry Association '96 Conference, It's a New World and Welcome to It, at 4 (Sept. 19, 1996).

III. CURRENT DIFFERENCES BETWEEN CELLULAR AND PCS MAY WARRANT TEMPORARY DIFFERENCES IN REGULATORY TREATMENT

Last November the Sixth Circuit directed this Commission to re-examine whether the cellular separate subsidiary rule "continues to serve as a necessary regulatory restriction on" the BOCs.[58] The court held that the Commission had failed to provide "a reasoned explanation" in its 1993 Broadband PCS Order for not re-evaluating the continuing need for the rule, given its decision not to impose a similar requirement on BOC provision of PCS.[59] The Commission now asks whether the cellular separate subsidiary requirement should be retained, removed, or modified, and, if not removed, whether the regulatory parity directive of the 1993 Budget Act dictates that the same (or modified) BOC/cellular restrictions be extended to BOC/PCS.[60]

Regulatory symmetry was, and remains, an important goal of the 1993 Budget Act.[61] However, Congress never intended "parity for its own sake":

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[58] Cincinnati Bell v. FCC, 69 F.3d 752, 768 (6th Cir. 1995). The Court did not require the Commission to eliminate the rule. Indeed, earlier this week it specifically rejected BellSouth's request to vacate the rule because, among other things, the Commission had commenced this proceeding to re-examine the continued need for the rule. *See* BellSouth v. FCC, Nos. 94-4113 and 95-3315 (6th Cir., Oct. 1, 1996).

[59] *See* ibid. The Court's conclusion that the Commission failed to provide "a reasoned explanation" for not re-evaluating the continuing need for the cellular separate subsidiary rule is unfair given that the Commission simply held, in a proceeding involving PCS, that "we do not believe the record in this proceeding provides enough information for us to eliminate the [cellular] requirement at this time." Broadband PCS Order, 8 FCC Rcd 7700, 7751 n.98 (1993).

[60] *See, e.g.,* Notice at 18 ¶ 37 and 50 ¶ 108.

[61] "The broad goal of this legislation," the Commission has stated, "was to ensure that economic forces — not disparate regulatory requirements — shape the development of the CMRS marketplace." Flexible Use NPRM, 11 FCC Rcd 2445, 2449 ¶ 19 (1996). The Commission has also recognized that regulatory parity is not an absolute goal. As Commissioner Chong declared recently, "we should strive where possible for regulatory parity." Remarks of Commissioner Rachelle B. Chong at Telestrategies' Wireless Broadband Conference, Independence Day of the Telecom Industry, at 7 (July 16, 1996)(emphasis added). *See also*

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